IN THE

Supreme Court of the United States

OCTOBER TERM, 1944

No. 681

WESTERN MESA OIL CORPORATION and EL SEGUNDO OIL COMPANY,

Petitioners,

vs.

EDLOU COMPANY, *et al.*, Landowners in El Segundo Community Lease No. Four-A; EDLOU COMPANY, *et al.*, Landowners in El Segundo Community Lease No. Two-B; A. A. McCRAY, Trustee for holders of overriding royalties in El Segundo Community Lease No. Four-A; A. A. McCRAY, Trustee for holders of overriding royalties in El Segundo Community Lease No. Two-B; A. A. McCRAY, WM. H. RAMSAUR and F. R. C. FENTON,

Respondents.

Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit and Brief in Support Thereof.

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SUBJECT INDEX.

TABLE OF AUTHORITIES CITED.

CASES.

MISCELLANEOUS.

STATUTES.

INDEX TO APPENDIX.

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Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

Western Mesa Oil Corporation and El Segundo Oil Company pray that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Ninth Circuit entered in this case.

Opinion Below.

The opinion of the Circuit Court of Appeals for the Ninth Circuit is reported in 143 F. (2d) 843.

Jurisdiction.

The judgment of the Circuit Court of Appeals on petition for rehearing was entered on August 8, 1944 [R. 262]. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Question Involved.

Is not the permissive authority which is derived from Section 357(1) of the Bankruptcy Act to divide creditors into classes and to treat them in different ways and upon different terms, restricted and limited by Section 366(3) of the Bankruptcy Act which requires as a condition to confirmation of an arrangement that the Court be satisfied that the arrangement is fair and equitable?

Statutes Involved.

The statutes involved may be found in the Appendix, *infra,* pp. 19 and 20.

Statement.

Briefly stated, the facts herein pertinent are as follows:

Sovereign Oil Corporation filed a petition for relief under the provisions of Chapter XI of the Bankruptcy Act. (11 U. S. C. A. Sec. 701 *et seq.* [R. 2].) Among its creditors were the holders of landowners' royalties who had claims for unpaid royalties or rentals on three wells

owned by the debtor, to-wit: Sovereign Wells No. 1, No. 2 and No. 4 [R. 158, 159].

The leases governing all three of these wells contained the customary provisions to the effect that forfeiture for nonpayment of royalties could be effected only after the lessee had failed to rectify the default within the ninety days from the giving of a written notice by the landowner to the lessee [R. 164, 165].

The debtor filed a revised plan of arrangement which included the following provisions:

> "Landowners' royalties which carry with them the right of forfeiture of the oil and gas leases under which such royalties are payable and where such right of forfeiture has not, prior to the filing of the petition in bankruptcy, been waived either in writing or by the conduct of the parties, will be paid in full in the same manner as priority claims. Where, however, the facts disclose that prior to the filing of the proceedings hereunder by the debtor, the landowners, by writing or by their conduct, have legally waived the right of forfeiture as to any of the unpaid royalties, the same will be treated the same as those in the class of unsecured creditors. Should any controversy arise as to the proper status of such claims of holders of landowners' royalties, the same shall be determined by the above entitled Court in the above entitled proceeding upon hearing after notice." [R. 81.]

The revised plan provided for the payment of unsecured creditors by the issuance of the capital stock of a new corporation on the basis of 20% of the amount of their claims [R. 82].

The revised plan further provided that:

> "* * * if there appear to be any objectionable claims filed, the debtor, or any party in interest, including the new corporation, shall have the right to object to the allowance of the same, and such alleged creditors shall participate in the plan as confirmed, only on the basis of the amount of their claims as may finally be allowed by this Court". [R. 84.]

The debtor, its receiver and Western Mesa Oil Corporation filed a petition for the determination of the status of the holders of the landowners' royalties [R. 51].

At the hearing before the referee in bankruptcy, the petitioners urged that (1) the landowners had not acquired the right of forfeiture because of their failure to give the required notices of default [R. 160, 161], (2) the right to declare a forfeiture had been lost because of the acceptance by respondents of royalties from the receiver [R. 189-191] and (3) the filing of unsecured claims in the bankruptcy proceedings by respondents had the effect of constituting a waiver of any right to claim priority [R. 198].

The referee determined the issues on the theory that the language of the revised plan which provided for full payment of landowners' royalties "which carry with them the right of forfeiture" constituted an agreement by the debtor to pay royalties in full where the leases contained foreclosure provisions [R. 72]. This was also the view taken by the District Court and the Circuit Court of Appeals [R. 131, 251]. The petitioners contended that the phrase "carry with them the right of forfeiture" can only mean a right of forfeiture perfected by the giving of the

notice required by the leases in order to give rise to the right to declare a forfeiture. The interpretation given to the plan of arrangement by the lower courts not only is inconsistent with the purposes and spirit of the plan of arrangement evidenced in the reading of such document as a whole, but the interpretation of the lower courts causes the plan to violate Section 366(3) of the Bankruptcy Act (11 U. S. C. A. Sec. 766(3)) which makes it mandatory that a plan of arrangement be "fair and equitable".

Specifications of Errors to Be Urged.

The Circuit Court of Appeals for the Ninth Circuit erred in adopting a construction of a plan of arrangement which creates an inequity between classes of unsecured creditors who are of equal standing, thus violating the requirements of Section 366(3) of the Bankruptcy Act that a plan of arrangement must be fair and equitable.

Reasons for Granting the Writ.

The decision of the Circuit Court that a plan of arrangement may provide for the treatment of unsecured creditors by classification on *any terms even though discriminatory,* is in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in the case of *Lane v. Haytian Corporation of America,* 117 F. (2d) 216, 220, and with the decision of the Circuit Court of Appeals for the Seventh Circuit in the case of *In Re Palisades-on-the Desplaines,* 89 F. (2d) 214 (decided under former Section 77b).

The decision below is also contrary to the principles expressed by this Honorable Court in *American United Mutual Life Insurance Co. v. City of Avon Park,* 311 U. S. 138, 61 S. Ct. 157, 85 L. Ed. 91.

The court below failed to give effect to Section 366(3) of the Bankruptcy Act in construing Sections 306, 351, 356 and 357 of the Bankruptcy Act (11 U. S. C. A. 706, 751, 756 and 757) as authorizing discriminatory treatment between classes of unsecured creditors irrespective of fairness and equity.

The legislative background of Section 357(1) was ignored by the court below. Its legislative sponsors commented that such section was subject to "the inherent restriction that the classification must be upon a reasonable basis and the express provision that the court must approve the plan as fair and equitable". (*Analysis of H. R. 12889, 74th Cong. 2d Sess. (1936) 42* (H. R. 12889 is the forerunner of the Chandler Act of 1938 now in effect).)

If the principle announced by the court below is generally followed, the essential principle and philosophy fundamentally underlying bankruptcy law, to-wit: "equity is equality" would be aborted.

This Honorable Court should review the decision so as to eliminate confusion arising from the conflict of decisions created by the court below, and avert the economic losses that will result from discriminatory plans of arrangements being confirmed on the authority of the decision of the instant case.

Conclusion.

It is, therefore, respectfully submitted that this petition should be granted.

October, 1944.

Respectfully submitted,

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